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BEFORE THE ARIZONA CORPORATION CC

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Arizona Corporation Commission

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MAY -5 2008

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AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION OF  
GOLD CANYON SEWER COMPANY FOR A  
DETERMINATION OF FAIR VALUE OF ITS  
UTILITY PLANT AND PROPERTY AND FOR  
INCREASES IN ITS RATES AND CHARGES  
FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. SW-02519A-06-0015

REHEARING DECISION 69664

STAFF'S CLOSING BRIEF

On June 28, 2007, the Arizona Corporation Commission ("Commission") issued Decision No. 69664 which approved a 72% rate increase for Gold Canyon Sewer Company ("Gold Canyon" or "Company"). The Residential Utility Consumer Office ("RUCO") filed a motion for rehearing pursuant to ARS § 40-253. In its petition for rehearing, RUCO alleged that the rate increase was "unfair", that the Commission should adopt RUCO's proposal of a hypothetical capital structure of 60% equity, and find that a portion of the constructed sewer plant is "excess" capacity. The Commission granted RUCO's request.

The purpose of ARS § 40-253 is to give the Commission the opportunity to reconsider its decisions and to correct its own errors before a party seeks judicial relief. *See State ex rel. Church v. Arizona Corp. Comm'n*, 94 Ariz. 107, 110, 382 P.2d 222, 224 (1963); *Cogent Pub. Serv., Inc. v. Ariz. Corp. Comm'n*, 142 Ariz. 52, 54, 688 P.2d 698, 700 (App.1984). Staff would contend that there were no errors made in Decision 69664. Staff believes that the Decision balanced the interest of the ratepayer by including in rate base the plant expansion and other upgrades which will provide ratepayers with a safe and well functioning plant. The Commission's decision was well reasoned and supported by the extensive record that was developed over six days of hearing in the original matter and an extensive briefing of the issues by the parties. Staff's positions remain unchanged from the

1 hearing below and Staff will not restate its positions here. Therefore, Staff supports Decision No.  
2 69664 and asserts that RUCO introduced no new or persuasive evidence to disturb the decision.

3 **I. GOLD CANYON'S PLANT ADDITION IS NOT EXCESS CAPACITY**

4 Staff believes that Decision No. 69664 properly found that there was no excess capacity.  
5 However, RUCO's position in its initial direct case was to disallow a portion of capacity in the Gold  
6 Canyon Water Reclamation Facility Phase 3 expansion. The recommendation further asserts that the  
7 existing ratepayers should not be burdened with 28.05% of the costs or \$1,867,723 of plant  
8 expansion. Tr. 1:10-18. On rehearing, RUCO offered no new evidence to rebut the finding that there  
9 was no excess capacity, but merely restated its position from the direct case. Tr. 1:9-21. To bolster  
10 its argument that there is excess capacity, RUCO also appears to use current customer data, data  
11 which would not have been known to anyone at the time Gold Canyon filed its rate application or  
12 made its decisions to expand its plant.

13 Indeed no new evidence was introduced by RUCO nor did they offer an engineering witness  
14 to support their position or rebut the company's plant operator testimony or Staff's engineer  
15 testimony. On the contrary, RUCO attempted to bolster its previous testimony through the testimony  
16 of Mr. Moore and Marylee Diaz-Cortez, neither of whom have experience in the design, permitting  
17 and operation of a wastewater facility. RUCO chose merely to restate a position that was rejected by  
18 Decision No. 69664. While the Commission has the broad discretion to re-review the evidence  
19 introduced below to ensure that it was fairly considered, Staff would contend that the testimony of the  
20 RUCO witnesses, who have no practical experience in wastewater operation, should be given little  
21 weight.

22 There are several flaws in the excess capacity arguments of RUCO witness Rodney Moore.  
23 First, in his calculations, Mr. Moore failed to include peak day average flow; rather, he mistakenly  
24 used average flows instead. Mr. Scott points out in his testimony, that Staff used a peak day flow and  
25 further stated that when 80% of the plant capacity is reached (1.52 MGD), ADEQ would require the  
26 Company to submit plans for additional capacity. Scott Direct Ex. 1, MSJ 4.

27 The determination of design and operational capacity cannot be calculated using accounting  
28 measures. Further, Mr. Moore used the incorrect assumption that a plant is only required to treat

1 average yearly flow. However, a treatment plant must be able to treat the peak day flow. Testimony  
2 from ADEQ representative William Hare, explained the necessary capacity for treatment pursuant to  
3 the Company's Aquifer Protection Permit. Tr. 134:25-135:1-24. No testimony offered by RUCO  
4 countered any of this testimony.

5 Mr. Moore uses a three-year horizon in calculating a "reserve margin" in RUCO's adjustment  
6 Tr. 3:13-15. However in his testimony at the Rehearing, Mr. Moore under questioning from both  
7 Staff and Administrative Law Judge Nodes, could not explain how he arrived at a three year planning  
8 horizon Tr. 68:14-25; 69:1-13. He also testified that he was unfamiliar with the time it would take to  
9 actually design a plant and was unfamiliar with the ADEQ rules for designing and planning capacity  
10 Tr. 70:9-23. RUCO offered no evidence to validate its assertions, it merely stated its accounting  
11 opinion regarding the planning and designing of plant in an effort to reduce Gold Canyon's rates. Mr.  
12 Scott testified that Staff disagreed with RUCO's use of three years and a reserve margin, stating that  
13 there needed to be technical input to RUCO's accounting process. Tr. 518:9-19.

14 RUCO attempts to rehabilitate its use of a three year planning horizon, by citing the  
15 Commission's decision in the rate application for Sun City West Utilities Company (SCWUC), a  
16 1982 decision (Decision No. 53166, Docket No. U-2334-81-008) for the proposition that three years  
17 is appropriate. In that decision, the Commission was exercising a right it had reserved to itself in the  
18 decision that granted a Certificate of Convenience and Necessity (CC&N) to SCWUC, to review the  
19 rates for water and wastewater service at any time. This decision does not stand for the proposition  
20 that a three year planning horizon is appropriate, in fact the decision reveals that the Commission  
21 undertook a review of the company's rates and plant two years after the initial grant of its CC&N.  
22 Further, SCWUC operations commenced at the time Sun City was brand new; Gold Canyon had been  
23 in operation for over 15 years when it filed the rate application that is the subject of this rehearing. It  
24 appears that the existing treatment facility was servicing 63% of the dwelling unit design capacity at  
25 the end of the test year. As was testified to in the instant case, ADEQ expects (as should the  
26 Commission) a company to start planning for expansion before it reaches capacity (keeping a buffer)  
27 and Staff believes it should be when a company reaches 80% of its operating capacity. Tr. 133:17-  
28 134:1; Tr. 1059:116-1040:5. The Commission was instructive in the SCWUC decision where it

1 acknowledged that "management must be allowed certain latitude in determining what plant is  
2 presently required to meet immediate future demand." The arguments put forward by RUCO  
3 regarding capacity are without merit.

4 RUCO also chides the Company for using "unrealistic" projections with respect to the number  
5 of service connections it projected it would have in 2008. Tr. 5:1-19; Tr. 102:2-7. The actual  
6 connections have been lower because of the slow down in the real estate market, a factor no one  
7 could have predicted when the Company submitted its rate application in 2006. It appears that RUCO  
8 is attempting to recast the Company's projections it used when planning its plant expansion on future  
9 data, data that could not have been known to RUCO, Staff or Gold Canyon at the time those  
10 decisions were made. The Company, as do other utilities that come before the Commission, is  
11 required to use the data it knew of at the time the projections were made, which would have been in  
12 test year 2005. While the Commission has broad discretion to consider all facts, including changing  
13 circumstances that occur from the time an application is filed up and through a rehearing procedure,  
14 Staff would argue that Gold Canyon acted prudently when it made its decision to build its plant  
15 expansion and that the Commission would be opening a Pandora's box, if it chose to reopen every  
16 rate decision because projections prudently made at the time of application fail to become a reality in  
17 the future. The Commission can always address a company's projections and the effect it has on  
18 rates when the Company files its next rate application. If need be, such a rate case could be ordered  
19 by the Commission.

20 Finally RUCO argues that even though the Company acted prudently but that the "excess  
21 capacity" is not used and useful. Tr. 72:8-13. Ms. Diaz-Cortez testified that her "opinions will not  
22 change on used and useful from a regulatory theoretical standpoint even if 10 engineers go up here  
23 and said from their point of view that it was used and useful." Tr. 83:15-18. However, the  
24 engineering expertise of Staff witness Scott should be given weight. Mr. Scott testified that a utility is  
25 expected to build and make capacity determinations with a five year planning period in mind. Tr.  
26 536:18-21. Mr. Scott further testified that the Company prudently projected its growth, using a five  
27 year planning period, based on the information it had at the time, and the plant expansion is used and  
28 useful. Tr. 537:4-17. A certain amount of extra capacity is desirable to meet the expected demands of

1 the immediate future in a growing community. When that capacity exceeds what is reasonable,  
2 ratepayers should not be required to provide a return on such excess. But the evidence presented by  
3 Staff and Gold Canyon established the reasonableness of the decision to expand the plant.

4 Staff is concerned that by adopting RUCO's adjustment, companies will be discouraged from  
5 making necessary and prudent plant improvements. Staff contends by shortening the Staff supported  
6 planning horizon of five years to RUCO's three year horizon would lead to an inefficient use of  
7 resources and actually cause more disruption and increase the cost to ratepayers. Given the  
8 intricacies of plant design, construction and permitting, Staff has determined that the standard of five  
9 years is more appropriate.

10 Although RUCO was not a party to the 2001 Gold Canyon settlement in Docket No. 00-0638,  
11 the willingness of the parties to enter into a settlement was premised, in part, on the belief that Gold  
12 Canyon's change in ownership from a developer owned utility to a separate investor owned company  
13 would improve the operation of the plant. As testified to by Marlin Scott, conditions of the plant  
14 were improved. Tr. 1042:19-1043:8. Gold Canyon has acted prudently in its plant expansion and in  
15 improved plant operations.

16 **II. DECISION NO. 69664 APPROPRIATELY CONSIDERED GOLD CANYON'S**  
17 **CAPITAL STRUCTURE AND IMPUTING A HYPOTHETICAL CAPITAL**  
18 **STRUCTURE IS INAPPROPRIATE**

19 The capital structure of 100% equity and zero debt set forth in Staff's initial case is what Staff  
20 continues to proffer. Staff used financial models that the Commission has relied on for many years.  
21 RUCO witness William Rigsby offers no new testimony; in fact his recommendations are the same  
22 recommendations he made in the original hearing in this matter. Tr. 5:11-15. One has to question  
23 why the matter was reopened if RUCO had no new evidence or testimony to offer, other than  
24 testimony that had already been offered, subject to the rigors of cross examination, and appropriately  
25 rejected by this Commission. However, Mr. Rigsby does offer testimony regarding several  
26 Commission decisions where a hypothetical capital structure was adopted as precedent.

27 Staff could not find a case where a hypothetical capital structure was imposed on a utility that  
28 increased the debt component. RUCO alluded to the fact that the Commission had previously

1 imposed a hypothetical capital structure to decrease equity, Tr.122:3-14, but did not cite any  
2 Commission decisions to support the testimony. In fact, a review of the cases cited by RUCO in Mr.  
3 Rigsby's direct testimony revealed that the Commission imposed a hypothetical capital structure to  
4 add equity to allow the cited companies to earn its rate of return. The cases RUCO cites stand for the  
5 proposition that a hypothetical capital structure was adopted because the companies in question were  
6 highly leveraged and a hypothetical capital structure was needed to adjust for the additional financial  
7 risk due to the leveraging.

8         In Southwest Gas (06-0403), Staff, RUCO and Southwest Gas all proposed a hypothetical  
9 capital structure. Southwest Gas' actual capital structure was 34.5% equity, 5.3% preferred stock and  
10 60.2% debt. Southwest Gas' equity position had been low for a decade (Decision 68487 at 24: 9-11)  
11 and in recommending a hypothetical capital structure, Staff's position was in line with previous  
12 Commission decisions regarding improving Southwest Gas' equity ratio.

13         In Tucson Electric Power ("TEP"), Decision No. 67454, the Commission adopted a  
14 hypothetical capital structure, because of TEP's poor financial condition. In another TEP matter,  
15 Decision No. 58497, the Commission added equity in its adoption of a hypothetical capital structure  
16 because TEP's capital structure was 100% debt. Mr. Rigsby contends that in these cases, the adoption  
17 of a hypothetical capital structure was for the benefit of those utilities, Tr. 26:9-10, and not the  
18 ratepayers. But he acknowledges that the Commission acted in the public interest, Tr. 25:19, and in  
19 acting in the public interest, ratepayers benefit. Ratepayers also benefit from financially sound  
20 utilities.

21         RUCO contends that a capital structure composed of 100% equity is imprudent. Tr. 86:11; Tr.  
22 29:4-6. While all parties acknowledge that a balanced capital structure is preferable, to suggest that a  
23 100% equity capital structure is imprudent is to imply that the Commission has acted improperly in  
24 the case of Rio Rico Utilities Inc, (Decision No. 67279), Goodman Water (Decision No. 69404) and  
25 Black Mountain Sewer, a company in the Algonquin family of companies (Decision No. 69164).  
26 These were all cases where the Commission adopted a 100% equity capital structure. In each of  
27 those cases, RUCO recommended a hypothetical capital structure and its recommendation was  
28 appropriately rejected by the Commission.

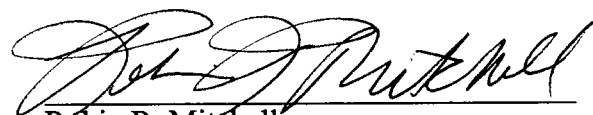
1 RUCO has offered no evidence, and certainly not clear and convincing, to make such  
2 unsubstantiated allegations that Gold Canyon acted imprudently or that the Commission in approving  
3 a 100% equity capital structure for Gold Canyon as well as a hosts of other companies, failed in its  
4 duty to find such capital structure imprudent.

5 While the use of a hypothetical capital structure is a method to balance a capital structure, the  
6 Commission has also recognized that the Hamada equation as used by Staff is an appropriate method  
7 to address a company's unbalanced capital structure. The Hamada equation uses quantifiable data  
8 and uses a company's actual capital structure. The Commission has adopted Staff's approach in  
9 numerous cases, and Staff's use of the Hamada equation was appropriate in this case.

10 **III. CONCLUSION**

11 RUCO has not introduced any new evidence that the Commission acted improperly in the  
12 Decision No. 69664. RUCO has recommended a hypothetical capital structure in a number of cases  
13 and by its own admission. Tr. 142:1-14. RUCO constantly cautions the Commission against single  
14 issue, results oriented rate making. But RUCO is encouraging that the Commission engage in the  
15 very behavior it eschews by using a hypothetical capital structure and the excess capacity argument  
16 solely to reduce rates.

17 RESPECTUFLY SUBMITTED this 5th day of May, 2008.

18 

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